Internal Revenue Service

memorandum

CC:TL-N-8370-88
CLRobertson,Jr.

date: NOV 4 1988

to: District Counsel, Laguna Niguel CC:LN
Attention: Susan Hergenhan, Esq.

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted] v. Commissioner, Dkt. No. [redacted], Claim for Filing Fee Pursuant to I.R.C. § 7430

This is in response to your request for technical advice dated August 7, 1988, on the petitioner's claim for her $[redacted] filing fee in the Tax Court.

ISSUE

Whether the Service should concede petitioner's claim for a $[redacted] filing fee under section 7430 based on the hazards of litigation. 7430-0000

CONCLUSION

We agree that the Service should concede the $[redacted] filing fee in this case based on the hazards of litigation.

FACTS

On June 5, 1985, a revenue officer was assigned a Taxpayer Delinquency Investigation (TDI) case concerning [redacted], the taxpayer in this case. The revenue officer's investigation included attempts to verify the address listed for taxpayer on the TDI through requests for last known address information from the Department of Motor Vehicles and also from the United States Postmaster.

The Department of Motor Vehicles reported no information on the last known address for the taxpayer. However, the revenue officer had requested information on a taxpayer with a last name spelled "[redacted]" rather than "[redacted]". No response was received apparently from the United States Postmaster. However, the address in the TDI administrative file on the TDI document dated [redacted], was the same address reported by the taxpayer on the petition filed on [redacted], with the Tax Court. On November 26, 1985, the assigned Revenue Officer forward the TDI

to the Fresno Service Center. The Fresno Service Center reviewed the case file and determined that the taxpayer owed income tax for [redacted] and [redacted]. The year at issue in this technical advice request is the year [redacted]. After making the above determination, the Fresno Service Center in accordance with the Substitute for Return Program closed the TDI.

On [redacted], a Substitute for Return was prepared for the taxpayer's [redacted] year. The examiner determined that during [redacted] the taxpayer has received W-2 wages in the amount of $[redacted] from an incorporated medical practice. In addition, the examiner determined that the taxpayer received W-2 wages of $[redacted] from a hospital. The taxpayer had tax in the amount of $[redacted] withheld during [redacted].

On [redacted], the examiner's workpapers indicated that a "dummy return" was entered into the Service computer. Your memorandum indicates your belief that this entry meant that on [redacted], the examiner entered the taxpayer's [redacted] Substitute for Return into the computer. On [redacted], the examiner determined through a computer check that the taxpayers had not filed an income tax return for [redacted].

On [redacted], however, the Service Center in Carson, California, received the taxpayer's [redacted] income tax return. This was a joint return filed with the taxpayer's husband, [redacted]. The taxpayers reported the W-2 wages discussed above. In addition, her husband reported a Schedule C business loss in the amount of $[redacted]. Based on these figures, the return indicated no income tax owed for the [redacted] taxable year. Federal income tax in amount of $[redacted] was reported as an overpayment. As noted above, this was the tax the taxpayers had withheld for [redacted].

On [redacted], the Chief of the Fresno Service Center's Underreporter Branch mailed the taxpayers a thirty day letter. Your memorandum indicates that the chief of this branch was apparently unaware that the taxpayer had filed a [redacted] tax return and that this was received on [redacted] by the Service in Carson, California. The thirty day letter stated that the Service had previously requested a [redacted] income tax return, but that there had not been a response. Further, the letter noted that based on the lack of response the Service was forced to conclude that the taxpayer did not intend to file a return. A report enclosed with the thirty day letter contained the Service's computations of taxes and penalties owed by the taxpayer for [redacted].

On October 1, 1986, approximately three weeks later, the Director of the Fresno Service Center sent the taxpayer and her husband a letter which acknowledged that on [redacted], the Service received the [redacted] [redacted] income tax return.

Additionally, the letter informed the [redacted] that the Service had disallowed their claim for $[redacted] because their [redacted] return was filed more than [redacted] years after the date it was due. */

The Service took no action during the next 9 1/2 months. However, On [redacted], the Service determined that the taxpayer had failed to respond to its thirty day letter. Accordingly, the Service sent the case to its 90 day section.

On [redacted], the 90 day section sent a notice of deficiency to the taxpayer for the taxable year [redacted]. In the Statutory Notice of Deficiency the Commissioner determined that the taxpayer had not reported her [redacted] income. Therefore, the Commissioner made an adjustment to reflect the wage income reported by the petitioner's employers. In addition, the Service asserted additions to tax under sections 6651, 6654, and 6653.

The petitioner's attorney filed a timely petition on [redacted], with the Tax Court. The petitioner is represented by her husband, [redacted]. On [redacted], the respondent filed a Motion To Extend Time Within Which to Answer from [redacted], to [redacted]. The motion was filed in order to allow respondent an opportunity to review the administrative file before filing an answer in the case. Chief Judge [redacted] granted respondent's motion on [redacted].

On [redacted], respondent received petitioner's return from the Fresno Service Center. On [redacted], respondent received the administrative file from the Laguna Niguel Appeals Office. Upon reviewing the administrative file and petitioner's [redacted] return, respondent determined that the petitioner had in fact reported her [redacted] wage income. On [redacted], respondent sent petitioner's attorney a decision document which stated that there was no deficiency and no addition to tax due from the taxpayer for the taxable year [redacted]. Respondent intended to simultaneously file this decision document with the answer conceding the case.

Your memorandum indicates that the petitioner's attorney refused to sign the zero decision document. [redacted] stated that he would not waive the petitioner's claim for litigation costs under section 7430 unless the Service agreed to pay the filing fee of $[redacted].

On [redacted], the respondent mailed the answer to the Tax Court conceding the case. To date the decision documents remain unsigned and the petitioner's attorney has not moved for an award of litigation costs under section 7430.

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*/ Under section 6511 the claim for refund made by filing a return should have been disallowed because it was not filed within two years from the time the tax was paid.

ANALYSIS

Before proceeding to an analysis of the petitioner's request for the $[redacted] filing fee, we would like to point out that amount involved here comes within the $[redacted] limit on settlement offers which may be made at the Regional Counsel level under Chief Counsel Notice N (35)000-41 on Decentralizing I.R.C. § 7430 settlements. Under this Chief Counsel Notice, the Regional Counsel (or district counsel if the authority have been so delegated) may now settle attorney's fee cases up to and including $[redacted] if desired. You may wish to consider use of the notice in future attorney's fees cases. Assuming that the taxpayer can demonstrate that her net worth does not exceed [redacted] dollars at the time litigation commenced, it would appear that this Chief Counsel notice would apply to this case.

Since the petition in this case was filed on [redacted], after the December 31, 1985, effective date of the Tax Reform Act of 1986, section 7430 amended by the Act is applicable to the instant case as you note in your request for technical advice. Under section 7430 as amended, a taxpayer may be awarded reasonable litigation costs if he establishes: that the position of United States in the civil proceeding was not substantially justified, section 7430(c)(2)(A)(i); substantially prevails as to the most significant issue or amount in controversy, section 7430(c)(2)(A)(ii); and has a net worth which does not exceed $2,000,000 at the time the adjudication was commenced, section 7430(c)(2)(A)(iii). In addition, the taxpayer must have exhausted all administrative remedies to qualify to recover reasonable litigation costs. Section 7430(b)(1).

As suggested above we assume that your office can verify that the taxpayer's net worth did not exceed $2,000,000 at the time litigation commenced thus satisfying section 7430(c)(2)(A)(iii). The taxpayer has substantially prevailed as to the most significant issue or set of issues or amount in controversy because your office has conceded the case. Thus, the taxpayer has satisfied section 7430(c)(2)(A)(ii). The taxpayer can argue persuasively that she has exhausted all available administrative remedies thus satisfying section 7430(b). Although she did not respond to the Service's 30 day letter dated [redacted], the Service had in fact received the taxpayer's [redacted] tax return on [redacted]. In addition, the Service acknowledged receipt of this return in a letter dated [redacted].

With regard to the requirement under section 7430(c)(2)(i) that the taxpayer establish that the "position of the United States" was not substantially justified, we note that the instant case is appealable to the Ninth Circuit. As you note in your memorandum, the Tax Court would be inclined to follow any guidance provided on this issue by the Ninth Circuit Court of

Appeals. You correctly note that there are presently no appellate opinions in the Ninth Circuit on the question of when the position of the United States is established for the purpose of determing whether the position of the United States in the civil proceeding was substantially justified under 7430(c)(2)(A)(i). Your memorandum outlines the split in the circuits on this issue under section 7430 prior to its amendment by the Tax Reform Act 1986. Under the pre-1986 version of section 7430, the Tax Equity and Fiscal Responsibility Act of 1982, the District of Columbia, Eighth, Tenth, and Eleventh Circuits and the Tax Court have held that the "position of the United States" was limited to the Service's litigating position. Wickert v. Commissioner, 842 F.2d 1005 (8th Cir. 1988); Ewing and Thomas, P.W. v. Heye, 803 F.2d 613 (11th Cir. 1986); United States v. Balanced Financial Management, Inc., 769 F.2d 29 1440 (10th Cir. 1985); Baker v. Commissioner, 83 T.C. 45 (1984), vacated and remanded on other grounds, 787 F.2d 637 (D.C. Cir. 1986). In contrast, the First, Fifth, Sixth, and Ninth Circuits as well as the Claims Court have allowed an examination of the Service's prelitigation position under the prior TEFRA section 7430. William L. Comer Equity Pure Trust, et al. v. Commissioner, (6th Cir., Sept. 9, 1988); Sliwa v. Commissioner, 839 F.2d 602 (9th Cir. 1988); Tax Analysts v. United States, 11 Cl. Ct. 802 (1987); Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986); Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985).

Although as noted above there are technically no Ninth Circuit appellate opinions which address this issue specifically, the Ninth Circuit in Sliwa v. Commissioner, 839 F.2d 9th 602 (9th Cir. 1988), did in fact indicate it was likely to construe "position of the United States" to include administrative activity as well as litigation activity in a Tax Reform Act of 1986 case under section 7430.

You note that the Tax Court might follow dicta referred to above in Sliwa v. Commissioner, supra. However, in Egan v. Commissioner, 91 T.C. No. 46 (September 28, 1988), the Tax Court reaffirmed its position that the government's litigating position is the "position of the United States" under section 7430 except in cases appealable to the Second Circuit. Although the Tax Court in this case will therefore focus on our litigating position, we do not think this is a good case to litigate this issue in the Ninth Circuit. The Ninth Circuit in an appeal might very likely find that the position of United States during the administrative action was not substantially justified because it sent a statutory notice of deficiency which determined that the taxpayer had failed to report her wages for the [redacted] taxable year when in fact it had received and acknowledged the taxpayer's [redacted] income tax return approximately one year before. Since, as a practical matter, the Service's administrative action gave the taxpayer no other remedy than a judicial remedy, the Ninth Circuit might determine as the

Second Circuit did in Weiss v. Commissioner, No. 88-4017 (2d Cir. June 27, 1988) reversing and remanding 89 T.C. 779 (1987), that it should be permitted to examine the government's administrative conduct.

In view of the above, we agree that litigating this case poses significant litigation hazards in a potential Ninth Circuit case. Furthermore, the small amount claimed by the taxpayer for its filing fee, supports the wisdom of settling this case for the $[redacted] filing fee amount.

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